

December 22, 2009

Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551

Re: Truth in Lending – Proposed Rule: Regulation Z Part 226;
Docket No. R-1366

Dear Members of the Federal Reserve Board:

Legal Aid of Western Michigan is a legal services organization providing legal representation to low income families and senior citizens in 17 counties in west Michigan, including the cities of Grand Rapids, Kalamazoo, Muskegon and St. Joseph/Benton Harbor.

The Home Ownership Preservation Project directs legal services to homeowners who are facing foreclosure. Michigan's high level of unemployment combined with predatory and "exotic" mortgage loans and the current economic crisis has led to one of the highest foreclosure rates in the nation. We counsel hundreds of homeowners a month regarding foreclosure. We have also litigated many cases involving the Truth in Lending Act as well as other consumer statutes. Simply put, we are trying to save homes. We are hopeful that the rules proposed by the Federal Reserve Board will help us save more homes.

We support the Board's significant changes in the disclosure rules, as well as the expansion of substantive rules. In this brief letter, we highlight the most important of the Board's proposed changes, as well as encourage the Board to use its authority to ban unfair mortgage practices more aggressively. There are many other issues which merit comment; for those, we refer the Board to the comprehensive comments provided by the National Consumer Law Center.

Good Start on Substantive Regulations. We appreciate the Board's ban on yield spread premiums. One cause of the irresponsible lending boom that led to the subprime mortgage meltdown has been the payment of "yield spread premiums" to loan originators – both lender employees and independent brokers – for giving borrowers loans with higher interest rates or disadvantageous terms such as prepayment penalties. We have seen a substantial number of loans where the interest rate is much higher, and therefore the payments are much higher, than the borrower would have otherwise been eligible. We have also seen situations where the homeowner was encouraged to pay points or a discount fee to lower their interest rate at the same time their broker was receiving a yield spread premium from the lender to raise their interest rate. Universally, the homeowners have no knowledge about what this fee is or how it affects the terms of their loan.

We support the Board's proposed ban on all yield spread premiums that are based on loan terms or conditions, including the loan amount. We do not support, however, any weaker versions of this prohibition. The Board should adopt the full ban on yield spread premiums. Consumers should not have to deal with loan originators who are going behind their backs to give them worse loans than those for which they qualify.

We also strongly support the Board's proposed ban on loan originators being paid from two sources – both the lender and the consumer. Limiting payment from one or the other will reduce the incentives originators now have to increase the price of the loans.

The Board Needs to Prohibit More Unfair Practices.

However good these substantive proposals are, they are not nearly enough. Even in the face of the current disaster in the mortgage market, it appears that the Board continues to rely on the discredited notion that better disclosures will prevent dangerous, predatory mortgage lending. In this sweeping rewrite of TILA rules – much of which is driven by recognition of the extent to which predatory lending has played in causing the current economic crisis – the Board still fails to use its authority to prohibit blatant and far-reaching unfair practices. With the important exception of yield spread premiums, the Board continues to allow creditors to write abusive, predatory loans, and is merely reworking the requirements for disclosing the abusive terms. Simply put, a failure to regulate these types of unfair and deceptive practices now will only lead to the re-

emergence of these practices in the future. We must learn from the current financial crisis to ensure it does not happen again.

To that end, the Board should obey the mandate of Congress to stop unfair practices in the mortgage market, and should –

- Ban Payment Option ARM terms for all loans secured by the borrower's principal residence.
- Extend the requirements currently applicable only to higher cost loans regarding the determination of the borrower's ability to repay, to *all* mortgage loans secured by a borrower's principal residence.
- Require underwriting for all adjustable rate loans to determine the borrower's ability to repay the highest possible payments that may be required under the loan terms (counting both alternative amortization terms and the highest permissible interest rates).
- Prohibit the initiation of a foreclosure unless the HAMP loan modification analysis and procedure have been completed.

Much Improved Disclosures. We do not believe that disclosures will adequately protect homeowners from most abusive mortgages. However, the disclosure rules are still very important so that consumers will be able to determine the real costs and risks of the loans they are evaluating. The key to making any disclosure worthwhile is to ensure that it is understandable by the average borrower and not so confusing that it is simply ignored in favor of the oral representations by the mortgage broker, which are often misleading if not completely false.

The new disclosures proposed by the Board are substantial enhancements over the very weak disclosures that mortgage borrowers have received in the past. Some of the highlights of the Board's proposed improvements include:

- **Much more meaningful definition of the APR.** As the annual percentage rate or "APR" is the single number that captures *all* loan costs, including not just interest but also hidden fees, it is important for it to be meaningful and accurate. The existing rules regarding which fees and charges must be included are full of holes. This Swiss cheese approach makes the APR a poor indicator of the true cost of a loan. We support the Board's

proposal to adopt a sweeping all-in rule that will make the APR much more useful. Under the new proposal, the finance charge will always include credit insurance premiums, fees for recording and releasing the security interest, almost all closing costs, and all settlement agent charges. These are very good changes.

- **Innovative, targeted disclosure of the particular APR offered to the consumer.** We also support the Board's proposal to require creditors to disclose a mini-chart that shows exactly how the APR offered to a particular consumer compares to the average rate for prime loans and to current rates for higher priced loans. This innovative requirement will help alert consumers whenever they are offered a bad deal – something that loan originators in the past have been able to obscure.
- **Final disclosures three days before closing.** Until a recent change in the law by Congress, creditors were not required to provide any TILA disclosures before closing on refinance loans. Consumers often arrived at closing only to find significant changes to important loan terms. Closing is far too late to back out of the loan even if the consumer is able to detect the change amid the piles of papers presented. Now, the Board is proposing two alternatives to address this problem. One would require re-disclosure and a three-day waiting period if *any* loan term changes. The other would require this only if the APR changed or an adjustable rate feature was added. The first of these proposals is far better and the Board should adopt it. In addition, the Board should tighten up its current rule, which allows consumers to waive these protections.
- **Major improvements in format and understandability of mortgage disclosures.** The Board has conducted extensive consumer testing and has dramatically redesigned all its disclosure forms. It has replaced obscure prose with tables and plain language. It has jettisoned disclosures (such as the Consumer Handbook on Adjustable Rate Mortgages) that consumers do not find useful. The Board has failed, however, to be sufficiently strict: in many instances, it has carefully crafted the easiest language for consumers to understand, yet inexplicably does not require creditors to use that language.

- **Much better disclosure of risky loan features.** The Board is requiring creditors to make special disclosures regarding certain risky loan terms:
 - Prepayment penalties
 - Interest-only payments
 - Negative amortization
 - Balloon payment
 - Demand feature
 - No-documentation or low-documentation loans
 - Shared equity or shared-appreciation

Up until now, the Board's rules required only weak, obscure disclosures, or no disclosure at all, of some of these features. This will be a significant improvement.

We very much appreciate how far the Board has come in its recognition of the harm that unfair practices can have on homeowners, neighborhoods, and the economy. We appreciate the many significant improvements that the Board is proposing to disclosure rules. We now urge the Board to use the authority Congress gave it to move more aggressively and affirmatively to stop the continuing unfair practices in mortgages. For more information and specifics on all of these suggestions, please see the comments of the National Consumer Law Center.

Thank you.

Sincerely,

LEGAL AID OF WESTERN MICHIGAN

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Cc: Michael Chielens, Executive Director
Legal Aid of Western Michigan